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E.O. 11652: GDS

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SUBJECT: ENERGY: MULTILATERAL CONTEXT FOR BILATERAL AGREEMENTS

REF: A. USOECD 1021; B. STATE 9616

1. SUMMARY. DEPSEC GEN ELDIN HAS OUTLINED CASE FOR MULTILATERAL AGREEMENTS AMONG OIL IMPORTERS AND BETWEEN IMPORTERS AND EXPORTERS, BASED ON COMMON ECONOMIC INTERESTS, THAT WOULD PROVIDE CONTEXT FOR ACCEPTABLE BILATERAL AGREEMENTS. KEY POINT THAT LARGELY RECONCILES APPARENTLY DIVERGENT INTERESTS IS RELATIVELY SHORT PERIOD FORECAST FOR OIL SHORTAGE, BASED ON SECRETARIAT'S CONCLUSION OF HIGH ELASTICITIES OF DEMAND AND OF SUPPLY FROM ALTERNATIVE SOURCES. END SUMMARY.

2. IN FOLLOW-UP TO REF A AND PARA 3, REF B, WE HAVE PROBED VARIOUS MEMBERS OF SECRETARIAT ON QUESTION OF
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MULTILATERAL FORMULA WHICH MIGHT PROVIDE CONTEXT FOR

NONDISRUPTIVE BILATERAL OIL IMPORTER-EXPORTER AGREEMENTS. SECRETARIAT THINKING HAS NOT MATURED TO POINT OF PRODUCING PAPER ON SUBJECT, AND MANY OBVIOUS QUESTIONS REMAIN UNANSWERED, BUT DEPSEC GEN ELDIN HAS ON PERSONAL BASIS GIVEN US HIS THINKING ALONG FOLLOWING LINES.

3. ELDIN BELIEVES THAT, ALTHOUGH SHORT-RUN INTERESTS OF PRODUCERS AND IMPORTERS DIFFER IN SOME RESPECTS, THERE IS A GROWING COMMON INTEREST IN (A) CONTINUING ECONOMIC PROSPERITY AND MONETARY STABILITY, (B) DETERMINATION OF PRICE FOR LONG TERM WHICH WILL BOTH AVOID WASTFUL INVESTMENTS IN ALTERNATIVE SOURCES BY INDUSTRIALIZED COUNTRIES AND PERMIT GRADUAL SUBSTITUTION OF OTHER INCOME SOURCES FOR PRODUCERS (E.G. THROUGH INDUSTRIALIZATION), AND (C) FINANCIAL SYSTEM THAT WILL PROVIDE SECURE ASSETS FOR PRODUCERS COMPATIBLE WITH STABILITY AMONG INDUSTRIALIZED COUNTRIES.

4. TRADITIONAL PRICE NEGOTIATION FRAMEWORK HAS COLLAPSED AND GIVEN WAY TO ANARCHIC SITUATION IN WHICH BILATERAL DEALS ARE BEING NEGOTIATED, PARTICULARLY BY IMPORTING COUNTRIES THAT HAVE RELIED LESS ON MAJOR OIL COMPANIES AND/OR THAT HAVE GOVERNMENT OIL TRADING ORGANIZATIONS THAT CAN BYPASS OIL MAJORS. BILATERALS POSE TWO MAIN DANGERS: (A) COMPETITIVE OVER-BIDDING ON OIL PRICES OR ON BARTER COUNTERPARTS, AND (B) DAMAGE TO COUNTRIES UNABLE TO MAKE SUCH ARRANGEMENTS, BECAUSE OF LACK OF TECHNOLOGY OR GOODS FOR SWAPS, POLITICAL SITUATION, OR WEAK BARGAINING POWER IN OTHER SENSES. BILATERAL BARTER DEALS MAY, ON THE OTHER HAND, INCREASE ABSORPTIVE CAPACITY OF PRODUCERS' ECONOMIES BY CREATING INCENTIVE TO IMPORT AND STIMULATING NEW KINDS OF INVESTMENT FOR DEVELOPMENT; ELDIN ASSURED US HE WAS NOT TALKING ABOUT ARMS, AND HE AGREED THAT SUCH INCREASE IN ABSORPTIVE CAPACITY WOULD PROBABLY BE MARGINAL.

5. ELDIN SEES TWO KINDS OF MULTILATERAL UNDERSTANDINGS TO CONSIDER:

A. PRODUCERS AND IMPORTERS MIGHT AGREE ON LONG-TERM OBJECTIVES FOR OIL PRODUCTION AND PRICES: BILATERAL DEALS WOULD BE RELATED TO SUCH OBJECTIVES.

B. IMPORTING COUNTRIES MIGHT AMONG THEMSELVES AGREE TO CONFIDENTIAL

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GUIDELINES, ANALOGOUS TO AGREEMENTS THAT APPLY IN FIELD OF TRADE POLICY, THAT WOULD GOVERN BEHAVIOR IN BILATERAL NEGOTIATIONS AND REQUIRE NOTIFICATION OF AGREEMENTS AND THEIR TERMS.

6. UNDER FIRST AGREEMENT, PRODUCERS WOULD BE ASKED (A) TO RENOUNCE POLICY OF EMBARGOS (AND PRESUMABLY OTHER POLITICALLY MOTIVATED PRODUCTION RESTRAINTS), (B) TO GIVE ASSUR-

ANCES ON PRODUCTION LEVELS, AND (C) TO AGREE TO FORMULA FOR PRICE LEVELS. PRODUCTION AND PRICE FACTORS ARE, OF COURSE, INTERDEPENDENT, AND WOULD HAVE TO REFLECT ECONOMIC REALITIES TO BE CREDIBLE. IN RETURN, IMPORTING COUNTRIES WOULD ASSURE PRODUCERS THEY WOULD MAKE BEST EFFORTS FOR STABILITY OF MONETARY SYSTEM AND PROTECTION OF PRODUCERS' ASSETS RECEIVED IN EXCHANGE FOR OIL, AND WOULD AGREE TO MAKE AVAILABLE TECHNOLOGY FOR DEVELOPMENT OF PRODUCERS' ECONOMIES IN OTHER FIELDS. ELDIN BELIEVES ONE REASON THAT PRODUCER GOVERNMENTS MAY FEEL IT DESIRABLE TO ACCEPT MULTILATERAL UNDERSTANDING ON CONTEXT WITHIN WHICH FUTURE PRICES AND PRODUCTION DECISIONS WOULD BE MADE IS THAT THEY DO NOT WANT TO RESTRICT THEMSELVES TO SPECIFIC MARKETS AND SOURCES OF TECHNOLOGY.

7. ELDIN HOPES THAT PRODUCER GOVERNMENTS WILL SEE NEED FOR LINEAR PROGRESSION OF OIL PRICES AS OPPOSED TO MUCH HIGHER PRICES THAN CAN BE SUSTAINED IN LONGER RUN, AS BEING MORE SUITABLE TO THEIR OWN DEVELOPMENT STRATEGIES. AS SECRETARIAT (MARRIS) HAS POINTED OUT, HOWEVER, INTERESTS OF DIFFERENT PRODUCERS MAY BE DIFFERENT BECAUSE THEIR TIME HORIZONS FOR DEVELOPMENT OF OTHER SOURCES OF INCOME DIFFER. IMPORTANT ELEMENT OF ELDIN'S THINKING WHICH MAKES THIS POINT LESS SIGNIFICANT (AND WHICH MAY REFLECT SECRETARIAT'S ANALYSES THAT SHOW RELATIVELY HIGH ELASTICITIES OF DEMAND FOR OIL AND OF SUPPLY OF ALTERNATIVE SOURCES OF ENERGY) IS THAT "OIL SHORTAGE" WILL BE OVER BY END OF THIS DECADE. THUS ALL PRODUCERS SHOULD CONSIDER PROSPECT OF REDUCED LEVEL OF DEMAND FOR OIL IN PLANNING FOR FAIRLY NEAR FUTURE. IMPLICATION IS THAT OPEC GOVERNMENTS MUST TAKE INTO ACCOUNT DECISIONS CONCERNING ALTERNATIVE SOURCES OF ENERGY TAKEN BY IMPORTER GOVERNMENT, EVEN IF (LIKE IRAN) THEY EXPECT TO BE LARGELY INDEPENDENT OF OIL REVENUES AS EARLY AS MID-1980S. CONFIDENTIAL

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IMPORTER COUNTRIES' ENERGY-SAVING MEASURES WILL HELP THIS PROCESS, THOUGH ELDIN SEES THEM AS ESSENTIALLY ONE-TIME REDUCTIONS IN DEMAND THAT CANNOT BE REPEATED AFTER FIRST YEAR OR TWO.

8. NEED NOW, ELDIN CONCLUDES, IS FOR MORE DISPASSIONATE DISCUSSIONS WITH PRODUCERS THAT WOULD HOPEFULLY ELIMINATE THE POLITICAL AND PERSONAL ELEMENTS AND FOCUS ON LONG-TERM COMMON ECONOMIC INTERESTS. BROWN

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